

infrastructure in the years to come. The national policies favoring increased investment in the communications infrastructure thus should apply no less to cable companies than to other market participants. Yet the current cable rate regulations leave cable operators with little means to make the investments necessary for these policies to be achieved.³⁹

V. THE COMMISSION SHOULD ALLOW CABLE OPERATORS TO RECOVER THE COSTS OF SYSTEM EXPANSION AND UPGRADES BY TREATING SUCH CAPITAL INVESTMENT AS EXTERNAL COSTS UNDER ITS PRICE CAP MECHANISM

The Commission has made clear its preference to regulate

full recovery of the capital investment in system expansion and upgrades will provide cable operators with the basic marketplace incentives to invest in such improvements.

Accordingly, Corning and Scientific-Atlanta submit that the Commission should modify its rate regulation rules to allow cable operators to recover their investment in system improvements, going forward, through a pass-through mechanism.

Such pass-throughs are supported by the 1992 Cable Act, which not only endorses these national objectives but also specifically contemplates that cable operators will recover their system costs. Section 623(b)(2) of the Act⁴⁰ provides that basic tier rates shall take into account the "direct costs" of transmitting signals carried on the basic service tier, as well as a reasonable portion of the joint and common costs of transmitting and providing such signals. Section 623(c)(2) of the Act⁴¹ explicitly provides that rates for cable programming services should recover the capital and operating costs of cable systems, which would include an incentive in the form of a return on investment. These provisions provide ample statutory support for pass-throughs of capital investment going forward, and indeed such a pass-through would well balance the competing considerations embodied in the Act.

⁴⁰ 47 U.S.C. § 543(b)(2).

⁴¹ 47 U.S.C. § 543(c)(2).

To implement pass-throughs, Corning and Scientific-Atlanta suggest that a cable system's per channel rate be adjusted to recover capital investment in advanced technology. The cable operator would thus be allowed to calculate its capital costs of system improvements, much like Schedules A and C call for currently as to operator's equipment costs.⁴² The cable operator could be required to apply straight-line depreciation over the life of the plant, with allowances for plant under construction, debt service, and a reasonable rate of return on the capital investment. When seeking to raise rates on this basis, the cable operator would be obligated to present its underlying calculations and rationale to the reviewing body upon request.

A decision permitting cable operators to recover capital costs in this manner would serve three critical interests. First, it would sustain cable's means for investing in the technology required to deliver better services to subscribers. Second, it would thereby advance fundamental goals of federal communications policy. Finally, it would spare both cable operators and an already overburdened FCC from becoming enmeshed in unnecessary cost-of-service proceedings.

⁴² Report and Order app. A and C.

CONCLUSION

For the foregoing reasons, Corning and Scientific-Atlanta urge the Commission on to reconsider its treatment of capital investment in system improvements and to allow such costs external treatment under its price cap mechanism.

Respectfully submitted,

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Appendix

**ESTIMATED IMPACT
OF
RATE RE-REGULATION
ON
CABLE TELEVISION CASH FLOWS
AND
CAPITAL EXPENDITURES**

JUNE 1993

**ESTIMATED IMPACT OF RATE RE-REGULATION
ON CABLE TELEVISION CASH FLOWS AND**

II. DESCRIPTION OF THE ANALYSIS

As described above, the overall objective of the analysis is to evaluate, for a representative sample of cable operators, the impact that the imposition of the rate re-regulation rules would have had on the cash flow generation and ability to support capital expenditures if these rules had been in place over the last several years (1990 to 1992). This analysis was constructed with actual financial data from several representative cable companies, which were aggregated to provide more of a "composite" view of the cash flow and capital expenditure impacts. The sections below outline the key elements of the analysis.

Company Selection Criteria and Industry Representation

The analysis is based upon the actual financial data of three cable operators for which public information is available. As shown below, data from the three companies was aggregated so as not to attribute cash flow and/or investment effects to particular companies. Criteria utilized to select the sample of three companies include company size, business concentration in the cable television industry, and company financial position as follows:

- The sample of three cable television companies was selected according to number of subscribers and revenue levels. In total, over six million basic subscribers are represented directly by the companies within the sample included in this analysis. Companies with similar subscriber bases to those within the sample represent over two-thirds of the basic subscribers of the top 100 cable system operators in the United States. Individual company size within the sample ranged from one to three million subscribers.
- Companies were selected for which the primary business was the ownership and operation of cable television systems. This selection criteria was established to isolate the impact of re-regulation on cash flow and capital investment on cable operators specifically, as opposed to entities for which cable television was only a part of a more diversified set of business activities.
- Companies of differing financial position were selected utilizing the measures of cash flow debt service coverage and debt leverage as measured by debt balances relative to cash flow generation. In fiscal year 1992, companies in the sample included in this analysis achieved the following financial relationships:

. Total debt coverage	1.5X
. Total Debt/cash flow (EBITDA)	7.1X

Methodology

For each company in the sample pool, the actual financial results for fiscal years 1990 to 1992 were compared to those results that would have likely been achieved under the revenue adjustments estimated by the FCC under the rules of the 1992 Cable Act. The analysis compares the pre-regulation revenues, operating margins and cash flow available for capital expenditures, to estimated post-regulation revenues, operating margin and cash flow available for capital expenditures that would have

been achieved under the regulated environment, holding all other factors constant. After evaluating the "pre-regulation" and "post-regulation" cash flow available for capital expenditures for each company individually, the individual financial results were consolidated to show the impact on an aggregate basis.

Assumptions Underlying the Analysis

The analysis is intended to be illustrative of the likely cash flow and capital investment impacts upon a composite of "typical" cable operators over a three year period (1990 to 1992). Several simplifying assumptions were utilized within the analysis which are described below:

- The analysis assumes that the rate regulation rules of the 1992 Cable Act were put in place at the beginning of fiscal year 1990, and is illustrative of the likely cash flow and capital expenditure impact of those rules over the period 1990 through 1992.
- The analysis assumes that basic service rates would be reduced by 10%, consistent with the estimates included in the FCC's order regarding cable rate regulation
- Pre-regulation operating relationships such as cash flow, operating margins, depreciation rates, etc. are a function of the actual financial results of the three companies included in our aggregated industry "composite"
- Revenue sources and distribution are consistent with general cable television industry averages as follows:

<u>Revenue Class</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>
Basic/CPS	60%	62%	62%
Premium/Pay Services	30	28	27
Ancillary Services	8	8	9
Advertising	<u>2</u>	<u>2</u>	<u>2</u>
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

- Rate increases on basic/expanded basic services enacted since September 30, 1992 were assumed to be 5%.
- The September 30, 1992 rates for basic/CPS were reduced by 10% to reflect the FCC's estimated impacts of rate re-regulation on the prices of these services. The resulting rate was rolled forward by 1.5% to capture the estimated impact of inflation since September 30, 1992; the inflation adjustment is allowed under the FCC rules on rate re-regulation
- For the purposes of this analysis, it has been assumed that once rates had been adjusted to reflect the impacts of the cable rate regulation rules in the first year of our analysis, the FCC's price cap mechanism would be instituted for basic services. In this analysis, it has been assumed that the price index that would be applicable to basic tier services would

increase basic tier revenues by 3% per year in 1991 and 1992. All other revenue streams have been held constant.

- Ancillary service revenues associated with installation and equipment have been assumed to be reduced by 33% (in 1990) in accordance with unbundling of equipment rentals and adoption of fees based on cost of providing equipment and installation services. In succeeding years, ancillary service revenues are assumed to grow at 3% per year.
- The analysis excludes any consideration of the potential impacts of cost of service filings on rate changes to various cable television system operators
- All other factors reflect actual results for the cable companies represented in our aggregate for the period 1990 to 1992.

III. IMPLICATIONS OF THE ANALYSIS

As stated above, one of the intended results of the 1992 Cable Act was to reduce rates to the cable consumer under the assumption the required rate reductions should not hinder the ability of the cable television industry to continue to provide quality services to consumers. Furthermore, the anticipated result of the adoption of regulatory rules implementing the Cable Act was a net reduction in cable industry revenues of between \$1.0 and \$1.5 billion dollars. However, implementation of the rules under the Cable Act will also produce a reduction in cable company cash flow, which will reduce the funds from operations cable companies have available to support system maintenance, upgrades, expansion and the introduction of new service capabilities.

This analysis demonstrates that had the rules under the Cable Act been in place over the last several years (1990 to 1992), the cash flow generating capacity and the ability of the aggregate sample of cable television companies to undertake meaningful capital expenditure projects would have been significantly impaired.

The analytical results which support this conclusion are summarized in the following points:

- Taking into consideration the estimated loss of rate increases cable operators have enacted since September 30, 1992, the prescribed rollback in basic and cable programming services rates projected by the FCC, and the preliminary industry estimates regarding the potential revenue loss on equipment and installations, the three cable operators included in our sample

- Interest payments are fixed financial obligations that must be met before funding for capital expenditures is typically considered. The effect of imposing the re-regulation rules upon the composite cable company included in this analysis would have rendered the aggregate cable company unable to meet interest payments during 1990 and substantially reduced their ability to meet debt obligations in fiscal years 1991 and 1992 (with very little coverage above actual interest payment levels). Interest coverage was adequate to meet debt obligations under the pre-regulation scenario in all three years included in the analysis 1990 to 1992.
- As noted in the above discussion, cash flow available for capital expenditures, while positive under the pre-regulation scenario, would have been negative in 1990, marginal in 1991 and positive during 1992 if the estimated rate re-regulation impacts had been in effect during 1990 to 1992. Under the pre-regulated environment, composite cable company generated over \$542 million dollars in funds available for capital expenditures during the three year period under review (1990 to 1992), while the imposition of the estimated impacts of cable re-regulation rules would have resulted in the generation of negative \$10 million dollars in funds available for network upgrades and expansion over the same three year time frame (1990 to 1992). Thus, the cumulative net cash flow reduction as a result of re-regulation would have been \$552 million (see Exhibit 2).

Furthermore, the above results ignore the effects of scheduled debt principal reductions. The cable companies in the aggregate sample included in this analysis were large net borrowers in fiscal years 1990 and 1991; borrowing was required to provide the funding to support the level of capital expenditures in the pre-regulation environment. In 1992 the debt leverage for the cable company composite included in our analysis incorporated the effect of some debt restructuring from debt to equity. Without this restructuring, funding would not have been available to support the level of capital expenditures undertaken in 1992. The net result is that cash flow available for capital expenditures was less than the level of required expenditures each year, under the pre-regulation scenario. Incorporating the estimated impacts of cable rate re-regulation would have significantly exacerbated this financial issue.

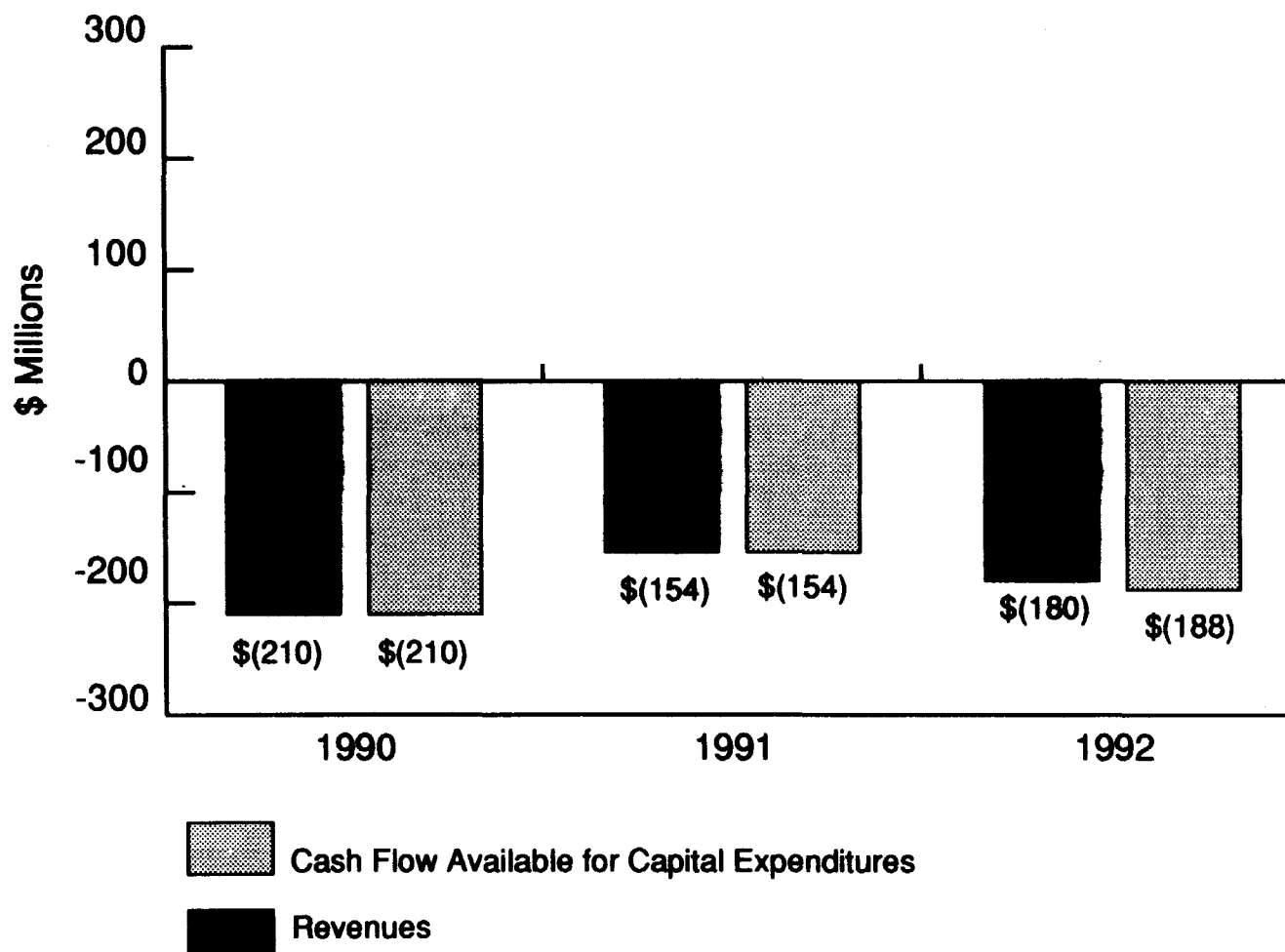
The net result of this analysis is that if the current regulatory rules were applied to a representative composite of cable company data from 1990 to 1992, the composite cable company in this analysis would have had insufficient cash flow to finance capital expenditures. Even without the impact of rate-

The post-regulation scenario illustrates the impact that would have occurred if the cable re-regulation rules had been in effect during 1990 to 1992. The composite company included in this analysis would

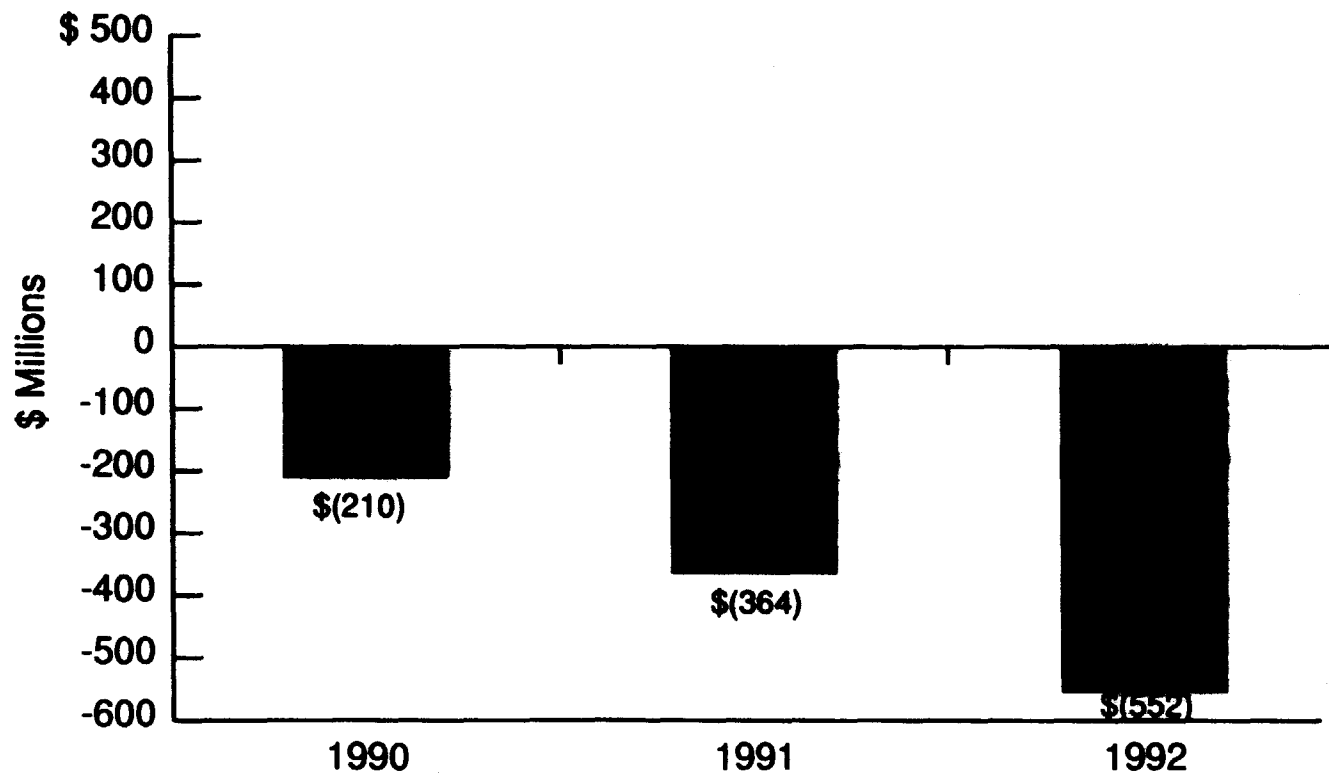
Due to the above, further impairment of cash flows over the period would potentially have come from the higher cost of capital (interest charges) over the period. Also, a potential acceleration of debt maturity would likely have occurred, further impairing "free" cash flow available for capital expenditures.

Based on the results of this analysis, capital expenditures for plant upgrades, expansion and the

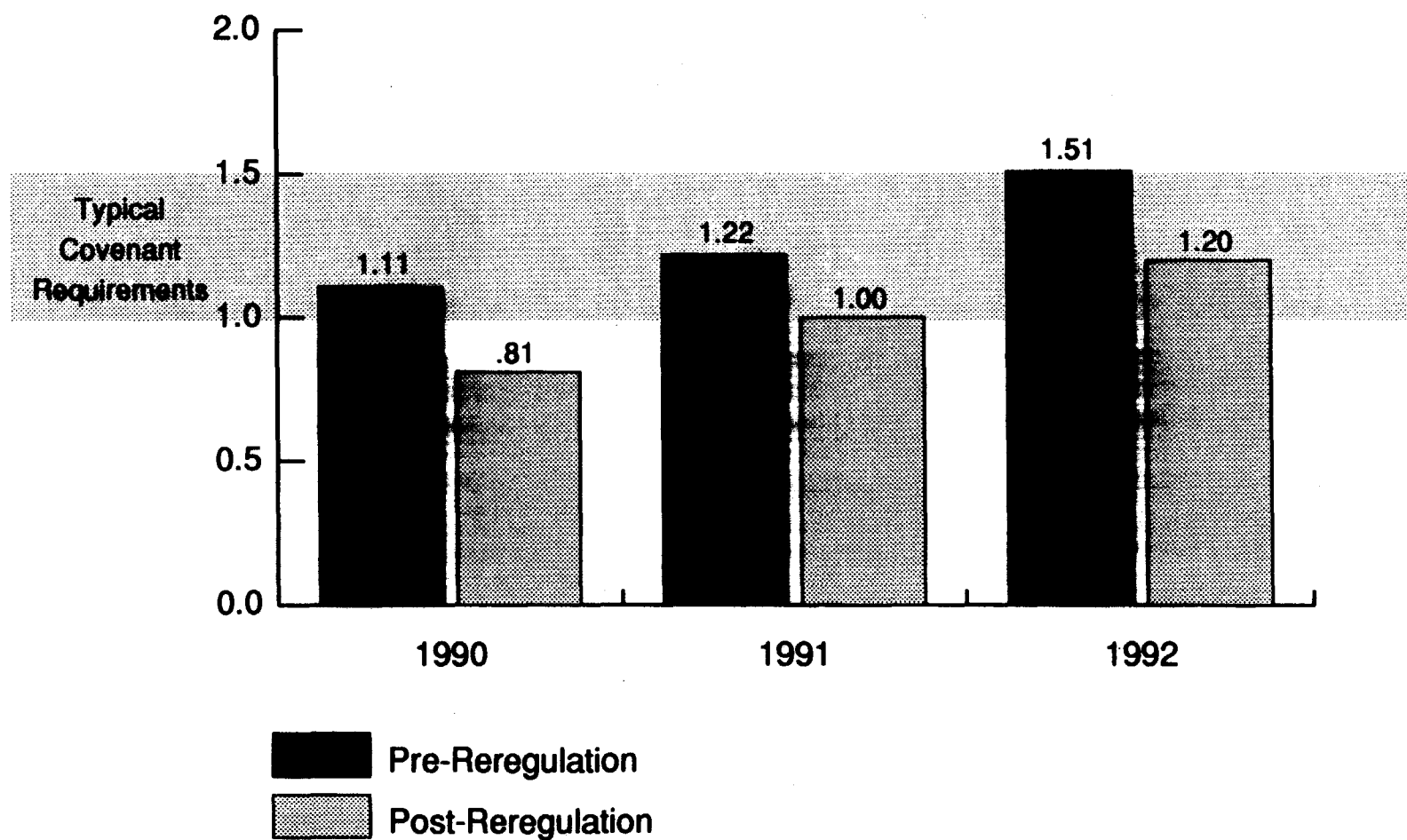
Estimated Impacts of Rate Reregulation on Revenues and Cash Flow



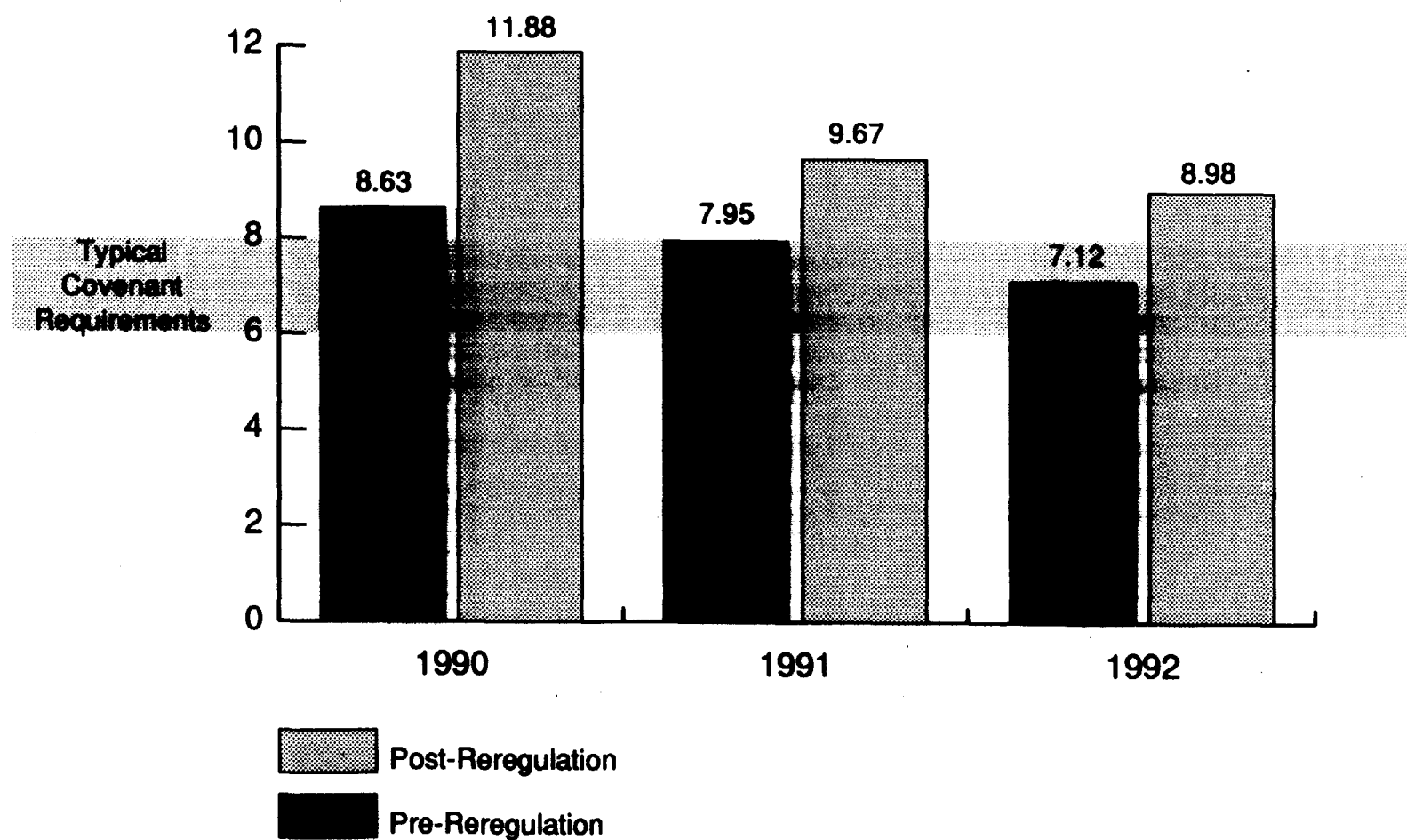
Estimated Impacts of Rate Reregulation on Cash Flow (Cumulative)



Estimated Impacts of Rate Reregulation on Interest Coverage



Estimated Impacts of Rate Reregulation on Debt/Cash Flow Ratio



CERTIFICATE OF SERVICE

I, Gladys Colon-Flowers, hereby certify that on this 21st day of June, 1993, I caused the original and 11 copies of the foregoing "Petition for Reconsideration" to be hand-delivered to:

Donna R. Searcy
Secretary
Federal Communications Commission
1919 M Street, N.W.
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Gladys Colon-Flowers